



August 16, 1999

ACTIVITY PROTOCOL

BACKGROUND

Since its inception in 1997, PJM Interconnection, L.L.C. (“PJM”) has been receiving numerous requests for services, software and other such activities from outside the PJM Control Area. Although the PJM Operating Agreement (“OA”) contains broad language which some parties believe permits PJM to engage in such activities, PJM has not acted upon these requests, other than by providing tours of PJM’s facilities or by providing speakers at seminars.

Based upon a PJM Members Committee resolution, the PJM Finance Committee held several meetings that were open to all Members to discuss the potential benefits to the Members of having PJM engage in Other Activities. Some Members believe that it would be in the best interests of PJM to engage in activities other than those specifically described in the OA (“Other Activities”), *inter alia*, because: (1) revenues from Other Activities could reduce the costs that Members currently bear; (2) Other Activities could benefit Members by contributing to a standardization of operational and market protocols in the industry; and (3) Other Activities could provide PJM with opportunities to further expand their expertise and thus provide improved service to the Members. The Members also discussed a number of concerns raised by Members and other constituent interests at the Finance Committee meetings.

In general, engagements in Other Activities should follow these principles: (1) PJM must engage in independent and non-discriminatory decision-making with regard to any activity that PJM is legally authorized to undertake; (2) Members should have the opportunity to provide general advice and recommendations concerning Other Activities; (3) Other Activities shall be conducted for the benefit of the Members of the LLC; (4) Other Activities shall not provide any Member or group of Members any undue access, any confidential information or any influence regarding the operation of the Interconnection; and (5) Other Activities must be subject to annual audits.

This Activity Protocol addresses the concerns of the Members, as follows:

1. MEMBERS SHALL BE KEPT ADVISED OF OTHER ACTIVITIES

PJM shall present information on proposed Other Activities to the Members at Members Committee meetings so that the Members shall be able to actively provide PJM with

appropriate advice and recommendations, in accordance with Section 8.8(iv) of the OA. This information shall include, for example, the general financial effects on PJM of conducting the Other Activity as well as the impact (if any) of the Other Activity on the existing operations and planning activities of PJM. However, due to the potentially commercially sensitive nature of some Other Activities, PJM reserves the right, in appropriate circumstances, not to disclose detailed financial or operating information concerning certain Other Activities. PJM shall also periodically provide feedback to the Members Committee comparing expected outcomes to actual results of Other Activities to enhance future project evaluations.

Members shall have the opportunity to discuss Other Activities at Members Committee meetings. Members shall also be entitled to provide written advice and recommendations to the Members Committee Chair, who shall compile all such input for submittal to the PJM Board. In addition, the Members Committee Chair shall have the right to request an opportunity to meet with the PJM Board to clarify and/or to expand upon advice and recommendations from Members. Final decisions as to whether to undertake any particular Other Activity shall be made exclusively by the PJM Board of Managers consistent with their fiduciary responsibility to govern the PJM Office of the Interconnection.

2. OTHER ACTIVITIES SHALL BE CONDUCTED CONSISTENT WITH THE OA

The PJM Board shall supervise and oversee all matters pertaining to Other Activities consistent with its responsibilities under the OA. Accordingly, the PJM Board shall only approve and PJM shall carry out Other Activities consistent with its duties and responsibilities as specified in, *inter alia*, Section 7.7 of the OA, to provide for: (a) the safe and reliable operation of the Interconnection; (b) the creation and operation of a robust, competitive, and non-discriminatory electric power market in the PJM Control Area, and (c) the principle that a Member or group of Members shall not have undue influence over the operation of the Interconnection.

3. MEMBERS SHALL BE INSULATED FROM LIABILITY FROM OTHER ACTIVITIES

In all cases, PJM shall take appropriate actions to properly insulate and indemnify Members from liability or risk of loss that may result from Other Activities. Depending upon the nature of the activity, Other Activity liability protections may include, but are not limited to, the following types of responses. Where appropriate, PJM should establish contractual indemnification provisions to fully indemnify PJM and its Members from risks and liabilities of all nature and manner that may be associated with an Other Activity. In other appropriate instances, PJM may form alliances with entities (such as consulting or technology firms) to have them assume all potential risks and liabilities associated with Other Activities. Such an option would include passive partnering with one or more consulting or technology firm(s) whose core business it is to market specialized expertise and technology to the electric industry. This is the preferred

approach for Other Activities and might be accomplished, for example, through appropriate lease or license arrangements. In other instances, where properly justified, PJM may establish an affiliated entity (such as a non-recourse, special purpose entity) that is sufficiently insulated from PJM and its Members to protect PJM and its Members from any and all liabilities related to Other Activities undertaken by such entity.

4. PJM SHALL MAINTAIN FOCUS ON ITS CORE FUNCTIONS

PJM shall maintain key human and financial resources and shall not dilute its existing efforts to exceed customer expectations and to maintain the reliability of the electric power system in every market it serves within the PJM Control Area. No Other Activities shall be conducted if to do so would run the risk of distracting PJM's focus on its central purposes. To ensure that PJM maintains the necessary focus on its core functions, PJM shall take appropriate actions as warranted, for example: (1) retain or assign specific employees to engage full-time in Other Activities, rather than risk diluting PJM's existing efforts; (2) monitor customer satisfaction through continued periodic customer satisfaction surveys to ensure that PJM employees are fully meeting the needs of the Members; and (3) establish clear lines of designated authority as to each PJM employee's responsibilities. These actions will ensure that PJM maintains appropriate focus on its core activities. However, if any Member has a concern regarding PJM's focus, such Member shall be entitled to present such issue in writing to the Board or discuss it with Board members at a PJM Liaison Committee meeting.

5. COSTS AND REVENUES ASSOCIATED WITH OTHER ACTIVITIES SHALL BE EQUITABLY ALLOCATED

PJM shall develop and implement auditable financial procedures to accurately track and account for all costs and revenues related to Other Activities. These procedures shall include, for example, regulatory accounting procedures to preclude the potential for cross-subsidization of Other Activities by Members. Net revenues resulting from Other Activities shall be equitably applied to offset appropriate PJM core activity expenses. Other Activities shall be subject to annual audit by external auditors. The scope of such audit shall be reviewed by the Audit Advisory Committee. Audit reports of Other Activities shall contain information concerning such activities, including a review of the annual revenues and expenses and an analysis of the applicable procedures to ensure equitable allocations. Summary data concerning Other Activities shall also be discussed with the Finance Committee as part of the budget planning process pursuant to Section 7.5 of the OA.